In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 217

GENERAL BANCSHARES CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION.

OPINIONS BELOW

The opinion of the Tax Court (Doc. No. 6) is reported at 39 T.C. 423. The opinion of the court of appeals (Pet. 11–20) is reported at 326 F. 2d 712.

JURISDICTION

The judgment of the court of appeals was filed on January 28, 1964. On April 21, 1964, Mr. Justice White granted an extension of time for the filing of a petition for a writ of certiorari to and including June 26, 1964, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

738-873—64

QUESTION PRESENTED

Whether costs incurred by the taxpayer in issuing its capital stock as a stock dividend are deductible as ordinary and necessary expenses of carrying on a trade or business under Section 162(a) of the Internal Revenue Code of 1954.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1954:

> SEC. 162. TRADE OR BUSINESS EXPENSES.
>
> (a) *In General.*—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.
>
> * * * * * * *
>
> SEC. 263. CAPITAL EXPENDITURES.
>
> (a) *General Rule.*—No deduction shall be allowed for—
>
> (1) Any amount paid out for new buildings or permanent improvements or betterments made to increase the value of any property or estate. * * *

Treasury Regulations on Income Tax (1954 Code):

> SEC. 1.162-1. BUSINESS EXPENSES.
>
> (a) *In general.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business * * *. Among the items included in business expenses are management expenses, commissions (but see section 263 and the regulations thereunder), labor, supplies, incidental repairs * * *.

STATEMENT

The taxpayer, a Missouri corporation, held stocks in controlled corporations in the banking and insurance fields, and the major part of its income consisted of dividends from these companies (Pet. 11–12). The taxpayer paid 2 percent stock dividends on its common stock in 1950, in October 1955, in April 1956, and in October 1956, and one of 6 percent in 1951. In 1957, the taxpayer issued two 2 percent stock dividends on its common stock, first in April and then again in October. Its 1957 income tax return disclosed an increase during the year in its common stock capital account of $174,775 and a charge to earned surplus of $174,736 for stock distributed to stockholders during that year (Pet. 12–13). It incurred expenses of $40,599.32 in connection with the issuance of the 1957 stock dividends, which, except for $2,801.02, the Commissioner refused to allow as a business expense deduction for that year (Doc. No. 6, pp. 2–3).

In sustaining the Commissioner's action, the Tax Court noted that the amount of the stock dividends became a permanent part of the taxpayer's stated capital, no longer available under local law for distribution as ordinary dividends. Thus, the stock dividends effected a permanent change in the taxpayer's capital structure. Relying on cases holding that expenses incurred by a corporation for its organization or for subsequent changes in the amount of its capital stock are considered to be non-deductible capital expenditures, even where no new capital or any tangible assets were acquired, the court held the stock dividend expenditures were not deductible as ordinary and

necessary business expenses. The court of appeals affirmed (Pet. 11–20).

ARGUMENT

Since the decision below is correct and there is no conflict in decisions, there is no reason for further review.

1. Section 263 of the Internal Revenue Code of 1964 provides that capital expenditures—including "[a]ny amount paid out for * * * permanent improvements or betterments made to increase the value of any property or estate"—may not be deducted. On the other hand, Section 162 allows a deduction for "all the ordinary and necessary expenses paid or incurred * * * in carrying on any trade or business." The regulations provide that the expenses must be "directly connected with or pertaining to the taxpayer's trade or business." Treasury Regulations on Income Tax (1954 Code), Sec. 1.162–1.

It is well established that expenditures incurred in organizing, reorganizing, and recapitalizing a corporation (including expenditures of stock issues which are part of any of these activities) are not deductible as ordinary and necessary business expenses. *E.g., Gravois Planing Mill Co.* v. *Commissioner*, 299 F. 2d 199, 206 (C.A. 8); *Shenandoah Rayon Corp.* v. *Commissioner*, 122 F. 2d 268, 271 (C.A. 2), affirming 42 B.T.A. 1287, certiorari denied, 314 U.S. 696. The same is true of outlays made to increase or issue a

Certain expenses in originally forming a corporation are now specifically amortizable, however, under Section 248 of the 1954 Code.

corporation's capital stock. *E.g., Baltimore & Ohio Railroad Co.* v. *Commissioner*, 29 B.T.A. 368 (and see the cases there cited, p. 372), affirmed, 78 F. 2d 460 (C.A. 4); *Borg & Beck Co.* v. *Commissioner*, 24 B.T.A. 995; Rev. Rul. 59-387, 1959-2 Cum. Bull. 56; I. T. 1836, II-2 Cum. Bull. 158 (1923). The rationale of the determinations is that the corporate advantage secured by the transaction, whether it be new capital, the retention of existing capital through a change in the corporate structure, or some other desired change in the corporate form, does not relate directly to the current income-producing business operation but, instead, primarily benefits the corporation for the indefinite future. See *Farmers Union Corp.* v. *Commissioner*, 300 F. 2d 197, 200 (C.A. 9), certiorari denied, 371 U.S. 861; *Motion Picture Capital Corp.* v. *Commissioner*, 80 F. 2d 872, 873 (C.A. 2); *First Nat'l Bank of St. Louis* v. *Commissioner*, 3 B.T.A. 807; 4 Mertens, *Law of Federal Income Taxation* (rev. ed.), Sec. 25.35.

These principles, as the Service has ruled (Rev. Rul. 60-254, 1960-2 Cum. Bull. 42), make clear that the cost of issuing a stock dividend is not deductible as an ordinary business expense.[3] The effect of a stock dividend on the issuing corporation, besides increasing the number of shares of stock outstanding, is to convert earned surplus into stated capital; as such, the amount of the dividend is no longer available for ordinary div-

[3] Contrary to the taxpayer's contention (Pet. [illegible]), there is no established administrative practice contrary to the position taken by the Commissioner in Rev. Rul. 60-254, and followed by the court of appeals in the instant case.

dend distributions. *Eisner* v. *Macomber*, 252 U.S. 189, 210–211; *United States* v. *Zions Sav. & Loan Assn.*, 313 F. 2d 331, 335 (C.A. 10). Thus, a stock dividend has no direct relationship to the carrying on of trade or business activities as required for deductibility by Section 1.162–1 of the Regulations. Instead, the stock dividend is in the nature of a betterment or improvement of the corporate structure, the costs of which are nondeductible as capital expenditures within the meaning of Section 263.

2. There is no conflict with other decisions. The only other cases involving the question presented here have been decided by the courts of appeals in favor of the Commissioner on the authority of the Eighth Circuit's decision in the instant case. *Arkansas Louisiana Gas Co.* v. *Commissioner* (C.A. 5), decided May 11, 1964 (64–1 U.S.T.C., par. 9483), affirming *per curiam* a decision of the Tax Court on March 15, 1963 (P-H Memo T.C., par. 63,077); *United Industrial Corp.* v. *Commissioner*, 331 F. 2d 605 (C.A. 6), affirming *per curiam* a decision of the Tax Court of November 28, 1962 (P-H Memo T.C., par. 62,280). The taxpayer's contention (Pet. 10) that the decision below was decided "in a manner conflicting" with decisions of this Court is without merit. Those cases, while involving the business expense deduction, raise entirely different issues.

3. Congress reviewed the area of corporate organizational expenses as recently as 1954 and allowed the amortization in Section 248 of certain expenses connected with the organization of corporations. It decided, however, not to grant tax relief for stock issu-

ance expenditures (H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 31, A64 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4056, 4201); S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 37, 224–225 (3 U.S.C. Cong. & Adm. News (1954), 4621, 4668, 4860–4861)) in the face of suggestions that a deduction or amortization be allowed for such expenditures, including outlays relating to stock dividends (House Hearings on General Revenue Revision, 83d Cong. (1953), pp. 167–168, 170, 174, 551, 599, 603–604, 1573; Senate Hearings on the Internal Revenue Code of 1954, 83d Cong., pp. 886, 888, 1050–1051, 1282, 2047–2441). Accordingly, as the court of appeals observed in the instant case (Pet. 20), "If a different conclusion is to be reached, that end is for the Congress and not for the federal courts."

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

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JULY 1964.

U. S. GOVERNMENT PRINTING OFFICE: 1964